IN THE

Supreme Court of the United States

OCTOBER TERM, 1950.

No. 416

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

MAX SWIREN,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI.

MAY IT PLEASE THE COURT:

Questions Presented.

The petitioner's statement of the questions presented is unacceptable. The questions presented are these:

1. Whether the amount received by respondent upon the sale of his partnership interest in excess of respondent's cost basis for such partnership interest was taxable to him as a capital gain or as ordinary income.

2. Whether the general rule that a partnership interest is a capital asset separate and distinct from the under-

lying partnership assets should be nullified by carving out for separate tax treatment certain underlying partnership assets.

Additional Statutes Involved.

In addition to the sections of the Internal Revenue Code included in the Appendix to the petition, Section 26 of the Illinois (Uniform) Partnership Act (Ill. Rev. Stats. (1949) c. 106½ §26) is involved. That section is as follows:

> §26—*Interest of Partner:* A partner's interest in the partnership is his share of the profits and surplus, and the same is personal property.

Additional Statement.

In order adequately to present the undisputed facts surrounding the sale of respondent's partnership interest, it is necessary briefly to restate them.

By agreement dated December 13, 1944, the petitioner sold to Benjamin V. Becker and Don M. Peebles, the other two proprietary partners, for a cash consideration of $40,000, "all of his share and interest in the firm" excepting only his interest in one special situation.[1] Messrs. Becker and Peebles, by the same agreement, assumed all the liabilities and obligations of the firm, including a promissory note payable to the City National Bank and Trust Company for $17,500, a lease, and the participations of junior partners, and indemnified respondent against any firm liabilities or obligations (R. 83-84, 57-58).

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[1] As the Court of Appeals made clear (R. 99, fn.), the exclusion of this special item is irrelevant to the present issues, and respondent's tax treatment of that item was unchallenged either by the Commissioner or the Tax Court.

Respondent negotiated the sale of his partnership interest exclusively with Mr. Becker. The Tax Court expressly found that "in arriving at the sale price there was no agreement reached or discussion had" as to the value of any of the underlying assets or accounts of the partnership (R. 83).[2] This finding was accepted by the Court of Appeals (R. 99, 100). The negotiations between respondent and Mr. Becker were confined exclusively to a discussion of the value of respondent's partnership interest as a whole. Solely for his own purposes, and as an aid in determining for himself the value of his entire interest in the partnership, the respondent placed his own estimates of values upon the underlying assets of the firm (R. 67, 83, 35-39). Included among these underlying assets were accounts receivable, together with potential accounts receivable which would arise from work in process upon its completion but which were not ready for billing because the work had not been completed (R. 102).[3] Respondent in-

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[2] Petitioner incorrectly states the finding as follows: "In arriving at the sale price, there was no **explicit** agreement or discussion concerning the value of any of the underlying assets of the partnership" (Pet. 5). The express finding of the Tax Court leaves no room for the intended implication (R. 83).

[3] Although petitioner persists in labeling these assets "fees which had been earned but not yet billed or collected," the record makes perfectly clear that they constituted in the main potential accounts receivable for work in process, not yet completed or ready for billing (R. 35).

As the Court of Appeals put it (R. 102):

> "The Commissioner here attempts to segregate partnership accounts receivable and unbilled fees for work in process and arbitrarily label both past earnings.
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> * * *
>
> "Uncollected fees for work in process not yet completed had not been transformed on the date of taxpayer's sale of his interest into gross income within the meaning of Section 183(b)(2), Internal Revenue Code."

formed Becker that he believed his interest in the partnership to be worth $45,000 to $50,000. Several days later, Mr. Becker offered respondent $40,000 for his interest, which offer was accepted (R. 99).

A supplementary agreement dated December 13, 1944, provided that all of respondent's interest in the income and expenses of the partnership terminated as at October 31, 1944 (R. 84-85, 99). Both the partnership and the taxpayer filed their tax returns upon a cash receipts basis (R. 100, 85). The net income of the partnership was $118,-708 for the taxable year in question (R. 85). These earnings consisted of the excess of collected fees over expenses actually paid (R. 76-77, 56). Respondent's distributive share of these earnings as at October 31, 1944, amounted to $29,917.26 (R. 85). Respondent returned and paid tax on his distributive share as ordinary income (R. 85, 100). Of the $40,000 that he was paid for his partnership interest, he reported $20,535.11 as capital gain. This was so much of the proceeds from the sale of his partnership interest as exceeded his cost basis (R. 85).

ARGUMENT.

I.

The decision below is in agreement with those of five other Courts of Appeals. There is no conflict.

The Court of Appeals determined that the gain from the sale of respondent's partnership interest was taxable as a capital gain.

In every circuit in which the nature of the gain or loss realized upon the sale of a partnership interest has been considered, the Court of Appeals has reached the precise result reached below. By now the Courts of Appeals for the Second, Fifth, Sixth, Seventh, Eighth and Ninth circuits have held that a sale of a partnership interest constitutes the sale of a capital asset regardless of the nature of the underlying assets. *McClellan* v. *Commissioner,* 117 F. (2d) 988 (C. A. 2d, 1941); *Commissioner* v. *H. R. Smith,* 173 F. (2d) 470 (C. A. 5th, 1949), *cert. den.* 338 U. S. 818 (1949); *Long* v. *Commissioner,* 173 F. (2d) 471 (C. A. 5th, 1949), *cert. den.* 338 U. S. 818 (1949); *First National Bank of Mobile* v. *Commissioner,* 183 F. (2d) 172 (C. A. 5th, 1950) (petition for certiorari pending, October Term 1950, No. 342); *Commissioner* v. *Shapiro,* 125 F. (2d) 532 (C. A. 6th, 1942); *Swiren* v. *Commissioner,* 183 F. (2d) 656 (C. A. 7th 1950); *United States* v. *Shapiro,* 178 F. (2d) 459 (C. A. 8th, 1949); *Stilgenbaur* v. *United States,* 115 F. (2d) 283 (C. A. 9th, 1940); *Commissioner* v. *Estate of Gartling,* 170 F. (2d) 73 (C. A. 9th, 1948).

There is no suggestion in the Commissioner's petition that any conflict has developed since 1949 when this Court denied certiorari in the *H. R. Smith* and *Long* cases, in both of which the Commissioner presented precisely the same questions as he presents here. All that has happened since then is that the Seventh and Eighth Circuits have

reached the same result. *United States* v. *Shapiro, supra; Swiren* v. *Commissioner.* And both before and after its decision in this case, the Tax Court has reached decisions identical to those of the Courts of Appeals. See *e.g. Estate of Jones* v. *Commissioner,* 3 T.C.M. 97 (1944); *Estate of Nitto* v. *Commissioner,* 13 T.C. 858 (1949) (reviewed by the entire Tax Court); *Luhrs* v. *Commissioner,* 9 T.C.M. 537 (1950).

Moreover, in all analogous situations, the Courts of Appeals and the Tax Court have treated a partnership interest as a capital asset under the tax laws. Thus, a partnership interest has a holding period and a cost basis of its own wholly separate from any of the underlying assets. *Commissioner* v. *Lehman,* 165 F. (2d) 383 (C. A. 2d, 1948), *cert. den.* 334 U. S. 819 (1948); *Thornley* v. *Commissioner,* 147 F. (2d) 416 (C. A. 3rd, 1945); *Ford* v. *Commissioner,* 6 T.C. 499 (1946) *acq.* 1946—2 C. B. 2; Section 113(a)(13), Internal Revenue Code. A deceased partner's interest in the partnership is a capital asset, the value of which is includable in his gross estate. *McClennen* v. *Commissioner,* 131 F. (2d) 165 (C. A. 1st, 1942). Partners purchasing a partnership interest from a selling partner acquire a capital asset and may not deduct the purchase price. *Hill* v. *Commissioner,* 38 F. (2d) 165 (C. A. 1st, 1930), *cert. den.* 281 U. S. 761 (1930); *Carter* v. *Commissioner,* 36 B.T.A. 60 (1937). And a partnership may have a taxable year separate and distinct from that of the individual partners, who realize taxable personal income, not as the income comes into the partnership, but at the conclusion of the partnership's taxable year. *Girard Trust Co.* v. *United States,* 182 F. (2d) 921 (C. A. 3rd, 1950); *Commissioner* v. *Estate of Mnookin,* 184 F. (2d) 89 (C. A. 8th, 1950).

To establish an asserted conflict, the petitioner relies upon the same three decisions that he relied upon when

unsuccessfully seeking certiorari in the *H. R. Smith* and *Long* cases, *supra.* In view of the subsequent agreement by additional Courts of Appeals, there is certainly no reason today to change this Court's 1949 determination that no such conflict existed as to warrant review.

The correctness of that determination is demonstrated by an examination of the three cases relied upon as establishing a conflict. (Pet. 13) *Helvering* v. *Smith,* 90 F. (2d) 590 (C. A. 2d, 1937), is plainly distinguishable in that there the Court of Appeals held, *first,* that there had actually been no sale of a partnership interest, and, *second,* that in any event, since the taxpayer had made no capital contribution and was entitled under the partnership agreement to receive only a proportionate share in earned fees, he had no partnership interest to sell. More significant, perhaps, is the fact, as the Court of Appeals below expressly recognized, that *Helvering* v. *Smith* has probably been overruled by *McClellan* v. *Commissioner,* 117 F. (2d) 988 (C. A. 2d, 1941) and *Williams* v. *McGowan,* 152 F. (2d) 570 (C. A. 2d, 1945).

Thus, in the latter case, Judge Learned Hand, who had written the opinion in *Helvering* v. *Smith,* stated that insofar as the *Smith* case had held that a partnership interest was not a capital asset, it had been overruled by the *McClellan* case, which had adopted the position taken by the Court of Appeals here. In the *Williams* case, the Court said (at 571):

> "It has been held that a partner's interest in a going firm is for tax purposes to be regarded as a 'capital asset.' *Stilgenbaur* v. *United States,* 9 Cir., 115 F. 2d 283; *Commissioner* v. *Shapiro,* 6 Cir., 125 F. 2d 532, 144 A.L.R. 349. We too accepted the doctrine in *McClellan* v. *Commisioner,* 2 Cir., 117 F. 2d 988, although we had held the opposite in *Helvering* v. *Smith,* 2 Cir., 90 F. 2d 590, 591. * * * "

In view of this specific discussion, it would take more than the inclusion of *Smith* with other decisions in a footnote to *Whitney* v. *Commissioner,* 169 F. (2d) 562, 567 (C.A. 2d, 1948) to resurrect *Smith* as authority on the question here involved.

The Court of Appeals recognized that *Doyle* v. *Commissioner,* 102 F. (2d) 86 (C. A. 4th, 1939) was not in conflict but was inapplicable to the facts in this case (R. 103). In *Doyle,* the taxpayer, after dissolution, sold his interest in a specific fee to one of his former partners and was taxed thereon at ordinary rates. There was no claim that a partnership interest had been sold.

Finally, petitioner points to *City Bank Farmers Trust Co.* v. *United States,* 47 F. Supp. 98 (Ct. Cls. 1942), which held that the holding period of a partnership interest must be determined by reference to the holding periods of the individual partnership assets. Since the case on its facts is not in point, the petitioner presumably regards the implications of the decision as being in conflict with the decision below. The *City Bank* case has never been followed and in *Commissioner* v. *Lehman,* 165 F. (2d) 383 (C. A. 2d, 1948), a case on all fours with the *City Bank* case, it was expressly repudiated. Nevertheless, this Court denied certiorari in the *Lehman case,* 334 U. S. 819 (1948). If this Court did not regard the conflict between *Lehman* and *City Bank* as then warranting review, it is difficult to see how the *City Bank* case can now provide such a conflict with the instant case as to warrant the granting of certiorari.

The petitioner candidly concedes that the present petition, together with his acquiescence in the taxpayer's petition in the *First National Bank of Mobile* case, No. 342, is an attempt on the part of the Commissioner to have this Court reconsider the same questions presented to it in the petitions for certiorari in *Commissioner* v. *Lehman,*

cert. den. 334 U. S. 819 (1948), in *Commisioner* v. *H. R. Smith, cert. den.* 338 U. S. 818 (1949), and in *Commissioner* v. *Long, cert. den.* 338 U. S. 818 (1949). (Pet. 12, fn.)[4] If the Commissioner thinks the situation warrants it, he may apply to Congress for relief, rather than repeatedly asking this Court to reconsider the same question in the absence of any disagreement among the Courts of Appeals.

II.

There is no conflict between the opinion below and G.C.M. 26379, but if there were, it would be immaterial.

The Commissioner also asserts that this Court should review the decision below, *first,* because the decision is in conflict with a recent General Counsel's Memorandum, and, *second,* because the asserted conflict illustrates that the Commissioner by unilateral action is unable to put an end to litigation.

Dealing with the second ground first, it seems clear that positions taken in a General Counsel's Memorandum are not to be accorded any greater weight than positions taken by the Commissioner in litigation or through Regulations. A taxpayer is always free to disagree with any position taken by the Commissioner, no matter what the form of expression, and if this were a basis for certiorari, we respectfully suggest that this Court's entire calendar would consist of federal tax questions.

We fail to see why the uniform decisions of six Courts of Appeals do not import such finality into the law as to relieve this Court of any further responsibility for review. And certainly the Commissioner's suggestion that

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[4] Although not cited either by the Court of Appeals for the Fifth Circuit, or by the Commissioner in his answer to the petition for certiorari in the First National Bank of Mobile case, No. 342, Commissioner v. Lehman, 165 F. (2d) 383 (C..A. 2d, 1948), cert. den. 334 U. S. 819 (1948), decided the same issues and is in complete accord with the position taken by the Court in that case.

otherwise litigation might continue until all ten Courts of Appeals have reached the same result, cannot be seriously advanced as a basis for the issuance of a writ of certiorari.

It is not accurate to say, as the Commissioner does, that the Court below "ignored" the exceptive provision of G.C.M. 26379 (Pet. 10). The Court considered the entire G.C.M., (R. 100), and plainly found the exceptive provision inapplicable by its terms. The G.C.M. abandoned the prior position of the Bureau and acquiesced in the "overwhelming weight of authority" that a partnership interest is a capital asset. The exceptive provision upon which the Commissioner relies was intended to limit the newly adopted position to those cases where the transaction was substantive and genuine, rather than fictitious and formal. Thus, the exceptive provision states:

> "The application of this rule should, of course, be limited to those cases in which the transaction in substance and effect, as distinguished from form and appearance, is essentially the sale of a partnership interest." (Pet. 31.)

But both the Tax Court and the Court of Appeals determined that this was in substance and in fact the sale by the respondent of his entire partnership interest (R. 83-85, 99, 100).

Moreover, the example given in G.C.M. 26379 of when the general rule will not be followed has no application here. The G.C.M. goes on to say:

> "For example, payments made to a retiring partner which represent his distributive share of earnings for past services should be treated as ordinary income rather than the proceeds derived from a sale of his interest." (Pet. 31.)

We take no exception to that statement. The respondent returned as ordinary income his distributive share of the partnership earnings, and both the Tax Court and the

Court of Appeals so found (R. 85, 100, 102). Neither the petitioner nor the Tax Court has suggested that taxpayer's partnership did not compute its income (and hence the taxpayer's distributive share) except in precise accordance with the applicable statutory provisions. Section 182(c), Section 183(b)(2) Internal Revenue Code. (Pet. 25, 26.)

But petitioner asserts that accounts receivable, together with potential accounts receivable from work in process not yet ripe for billing or collection, were properly a part of the respondent's "distributive share of partnership earnings" and therefore not a part of his partnership interest. This argument has been unsuccessfully advanced by petitioner in nearly every one of the cases decided by the Courts of Appeals and noted above. See *e.g.*, petitions for certiorari in *Commissioner* v. *H. R. Smith*, October Term, 1949, No. 120, *cert. den.* 338 U. S. 818 (1949); *Commissioner* v. *Long*, October Term, 1949, No. 121, *cert. den.* 338 U. S. 818 (1949). It is in conflict with the precise provisions of Sections 182(c) and 183(b)(2) of the Code. The opinion of the Court below disposes completely of the Commissioner's argument. As the Court said (R. 102):

> "The Commissioner here attempts to segregate partnership accounts receivable and unbilled fees for work in process and arbitrarily label both past earnings. The Commissioner argues that fees billed but uncollected, together with potential fees for work in process but not ready for billing or collection were taxpayer's 'distributive share of partnership earnings' and therefore not a part of his partnership interest. We cannot agree.
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> "When taxpayer purchased his interest in the firm he became entitled to his proportionate share of all fees collected by such partnership, and a portion of such fees had on the date of his purchase been billed but uncollected and other fees were for work then in process. Such fees when collected were ordinary

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> "When taxpayer purchased his interest in the firm he became entitled to his proportionate share of all fees collected by such partnership, and a portion of such fees had on the date of his purchase been billed but uncollected and other fees were for work then in process. Such fees when collected were ordinary

income and those receiving them, including taxpayer, paid a tax thereon for ordinary income.

"Taxpayer was on a cash receipts basis, as was the partnership. Uncollected fees for work in process not yet completed had not been transformed on the date of taxpayer's sale of his interest into gross income within the meaning of Sec. 183(b)(2), Internal Revenue Code.

"In various of the cases heretofore cited, listed among the partnership assets were such items as accounts receivable, rents receivable and unfinished work which in due course would yield gross income to the partnership. Nevertheless the various Courts of Appeals and also the Tax Court treated the partnership interest as a whole, without regard to the nature of the underlying assets, and held the interest to be a capital asset."

To hold otherwise than did the Court of Appeals would be to hold that upon the sale of a partnership interest there is also separately sold certain underlying assets of a non-capital nature which are somehow carved out or separated from the partnership interest for separate treatment. As all of the Courts of Appeals have recognized, such a treatment is inconsistent with the nature of a partnership interest. Under the applicable section of the Illinois (Uniform) Parnership Act and all of the authorities, a partnership interest consists of the surplus of the assets over the liabilities, and a partner has no individual interest in any particular asset. This alone is enough to make inapplicable those cases relied upon by petitioner, that render ineffective the commutation of rights to future payments or the anticipatory assignment of future income. (Pet. 16-18)

Although in the Court of Appeals petitioner conceded that Illinois law controlled the determination of the nature of respondent's partnership interest, he now contends that the asserted error of the Court of Appeals was the

result of its reliance on Illinois law. (Pet. 18-19).[5] The petitioner's reversal of position here is undoubtedly an attempt to avoid the near finality which this Court gives to determinations of local law questions by the Courts of Appeals. *Spiegel's Estate* v. *Commissioner,* 335 U. S. 701 (1949); *Helvering* v. *Stuart,* 317 U. S. 154 (1942). The nature of respondent's partnership interest was governed by Illinois law. *Commissioner* v. *Lehman,* 165 F. (2d) 383 (C.A. 2d, 1948); *cert. den.* 334 U. S. 819 (1948); *Commissioner* v. *Smith,* 173 F. (2d) 470 (C.A. 5th, 1949), *cert. den.* 338 U. S. 818 (1949). And the Court of Appeals in the present case correctly determined that under Illinois law a partnership interest was a species of property wholly separate and distinct from the underlying assets. Illinois (Uniform) Partnership Act, Ill. Rev. Stats. (1949) c. 106½ § 26; *Lindley* v. *Murphy,* 387 Ill. 506, 513-514 (1944); *Lueth* v. *Goodknecht,* 345 Ill. 197, 199-200 (1931).

But even if the question be regarded as a federal question under the Revenue Act, the same result would be reached. In adopting the Revenue Act, Congress was aware of the fact that under all of the decisions dealing with the question, the partnership interest was held to be distinct and separate from the underlying partnership assets. See, *e. g. Blodgett* v. *Silberman,* 277 U. S. 1 (1928) (construing the New York (Uniform) Partnership Act), and *Case* v. *Beauregard,* 99 U. S. 119 (1878) (nature of partnership interest prior to the Uniform Partnership Act). *Cf. United States* v. *Kaufman,* 267 U. S. 408 (1925). The acquiescence by Congress in the local law is shown by Section 113(a)(13) of the Internal Revenue Code

[5] Petitioner argued the Illinois law at length in the Court of Appeals, and at page 24 of his brief said this: "State law is often controlling as to the nature of a property interest and may be deemed to be so here."

which makes clear that a partnership interest is a capital asset with a cost basis of its own.

This Section deals with the basis of property acquired by a partnership and the basis of the partnership property after it has been distributed in kind to a partner. The Section, to the extent relevant, provides:

> "If the property was distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner *shall be such part of the basis in his hands of his partnership interest* as is properly allocable to such property." (Emphasis supplied.)

It must be apparent that if there were no distinction between a partnership interest and the underlying assets, it would be unnecessary to provide a substituted basis when the underlying asset is distributed in kind to the individual partners.

In the Section just quoted, Congress provided for a substituted basis in recognition that a partnership interest is a distinct type of property. It is, therefore, a capital asset within the meaning of Section 117(a)(1), Internal Revenue Code. (Pet. 23.) The Court of Appeals in the *First National Bank of Mobile* case expressly recognized that this was the correct meaning to be ascribed to the inclusion of Section 113(a)(13). 183 F. (2d) at 173. For a full discussion, see *Brooks, The Strange Nature of the Partnership Under the Income Tax Law,* 5 Tax L. Rev. 35, 41 (1949).

III.

The question presented is of no importance to the revenue.

The determination of the questions presented does not affect the revenue. As the Commissioner concedes, the question presents "an arguable issue whose resolution either way sometimes redounds to the benefit of the tax-

payer and sometimes to the benefit of the Government." (Pet. 9.) This is well illustrated by the fact that the taxpayer petitioned for certiorari in the *First National Bank of Mobile,* case No. 342, while the Commissioner is the petitioner in the instant case, although the results reached by the Courts of Appeals for the Fifth and Seventh Circuits were completely harmonious. Even in this very case the revenues are not adversely affected. Respondent reported a capital gain upon his sale of his partnership interest. In addition, as the underlying partnership assets ripen into taxable income in the hands of the continuing partners, it will be taxable to them at ordinary rates. *Hill* v. *Commissioner,* 38 F. (2d) 165 (C.A. 1st, 1930), *cert. den.* 281 U. S. 761 (1930); *Carter* v. *Commissioner,* 36 B.T.A. 60 (1937).

CONCLUSION.

The Courts of Appeals for six Circuits are in agreement on the question presented and this Court has refused to review the same issue on three prior occasions. The subsequent agreement by additional circuits only strengthens the prior determination of this Court that the question presented is not appropriate for review. There is no danger to the revenue since the result reached operates sometimes in favor of the Government and sometimes in favor of the taxpayer.

For the reasons heretofore assigned, the petition for writ of certiorari should be denied.

Respectfully submitted,

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December 8, 1950.